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SUBJECT: IMF Speaks on Vietnam's Macroeconomic Policy

¶1. (SBU) Summary: The IMF Country Director for Vietnam gave a briefing on Vietnam's macroeconomic performance for the second half of 2007. The IMF concluded that economic growth and performance was and will continue to be strong, but that certain macroeconomic policies are contributing to inflation and overheating. Vietnam needs more exchange rate and interest rate flexibility, and should tighten banking supervision in order to control credit growth. The Country Director does not believe that inflation will be a threat to political stability. End summary.

¶2. (SBU) The IMF Country Director, Benedict Bingham, gave a briefing to multilateral development banks and diplomats in mid-January to discuss the results of the IMF's bi-annual discussions with Vietnam, which were conducted in early December. The discussions narrowly focused on macro-economic issues and were conducted primarily with the State Bank of Vietnam (SBV). Bingham asked that the material be kept within government circles and not disseminated to the press.

Performance Is Strong, Maybe Too Strong

¶3. (SBU) The IMF delegation concluded that Vietnam's economic performance for the latter half of 2007 continued to be robust, with growth at approximately 8.5%. Export growth was and continues to be solid and FDI is rising rapidly. The IMF complimented the GVN's fiscal management capabilities. The delegation did, however, see some signs of overheating in the second half of the year, including inflation (which was 10% at the close of November, 12% at the end of December) and a widening current account deficit that is increasingly financed by short-term inflows instead of FDI and ODA. The IMF view is that the overheating has been caused primarily by rapid credit growth and heavy-handed management of the foreign exchange rate to keep it from appreciating. There is also some evidence that an increase in public sector borrowing, mostly by state-owned enterprises (SOEs), was also a factor in the overheating.

Monetary Policy Imports Inflation

¶4. (SBU) The IMF further concluded that the GVN policy of keeping the dong pegged to the dollar has led to depreciation against other currencies in the area and amongst trading partners, leading to the import of inflation into the domestic market. As capital inflows increased in 2006 and 2007, the SBV was forced to intervene on a substantial scale, while its capacity to sterilize was limited. The

resulting surge in liquidity fueled credit growth.

Advice to the SBV

¶5. (SBU) The IMF delegation recommended that Vietnamese authorities tighten monetary conditions to contain the rapid credit growth. The primary challenge for the SBV is to reorganize its monetary policy tools so that it is better able to respond to changes in the economy. The IMF recommends that the SBV should: 1) gain control of the short term interest rate and then increase that rate, and 2) make the exchange rate more responsive to market pressures. The IMF team focused its efforts on the SBV and reports that the SBV is aware of these issues and agreed with the IMF recommendations.

¶6. (SBU) The IMF acknowledges that the SBV controls neither the dong's valuation nor interest rates, but believes that the SBV should try to gain more control over these rates in an effort to control inflation. Bingham said that this debate needs to take place across the entire GVN, and that development banks and embassies need to carry these messages to other ministries outside the SBV.

Better Banking Supervision Needed

¶7. (SBU) The IMF noted that rapid credit growth was creating demand which may lead to vulnerabilities in the banking sector. The smaller banks were expanding credit at 70-80%, which, combined with rapid expansion of bank infrastructure (new branches with less experienced managers), might lead to a decline in the quality of lending. The IMF encouraged the SBV to focus on supervision of banks whose lending activities had become problematic, so that "targeted intervention" was possible. The banking system needs to

be "deepened" rather than "widened" - in other words, greater experience, but fewer banks. The SBV was also aware of this issue.

Inflation Not a Threat to Political Stability

¶8. (SBU) Asked if inflation might impact political stability, Bingham answered plainly "No." He recognized that it had become an issue in other countries, but did not see a similar situation arising here in Vietnam.

¶9. (SBU) Comment: The Ambassador hosted a dinner for a number of economists (including Bingham) and business people shortly after the IMF briefing. One of the topics of conversation was the Prime Minister's recent public rebuke of the SBV governor for failing to keep inflation down. Bingham and others did not interpret the attack as being directed against the new governor's performance because he has only been in office for a few months and is an old friend of the PM. Instead, they thought the PM used the scolding to provide political cover for initiating a change in monetary policy. There is evidence Vietnam is indeed heeding the IMF's advice as the SBV just announced on January 17 that it would be requiring urban banks to raise their reserve requirements in order to control inflation. The quandary for the PM is that a tighter monetary policy might well come at the expense of economic growth, at least in the short term. End comment.

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